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SUBJECT: RESERVE BANK SIGNALS ECONOMIC RECOVERY

11. (U) SUMMARY. The Reserve Bank of Australia (RBA) believes the economy has weathered the global financial crisis better than expected. The RBA Governor stated August 13 that this may turn out to be one of Australia's mildest post-war downturns. The RBA believes its monetary policy has been effective and expects continued signs of recovery, leading to an almost certain rise in interest rates in the near future. The Government is more cautious, believing that while performance to date has been much better than expected, there are some significant downside risks in the second half of 2009. END SUMMARY.

ECONOMY RESILIENT THROUGH CRISIS

12. (U) Reserve Bank of Australia (RBA) Governor Stevens stated on 14 August before a House of Representatives' Standing Committee on Economics that this could be "one of the shallower recessions Australia has experienced". He noted that external conditions facing Australia have improved, as global output has stabilized -- improved in East Asia -- and trade and industrial production increased in recent months. Domestic demand held up with retail sales rising in the first half of 2009. Though core inflation has remained worryingly high (an annualized rate of 3.2% in 2009Q2) headline inflation has fallen significantly to 1.5 percent over the year to June. Unemployment, after rising quickly from record lows in early 2008, has held relatively steady at about 5.8% in the past three months. Consumer confidence received a boost from a rise in household net worth, caused by increases in house prices as well as housing credit.

COMMODITY DEMAND DRIVEN BY CHINA

13. (SBU) Stevens emphasized that an important factor in the country's resilience was the vitality of its exports, which rose over the six months to March -- compared to falls for most other countries in the same period. China's continuing appetite for resources, aided by that country's massive economic stimulus program, has been largely responsible for this. Some economic recovery in Japan and Korea -- both leading trade partners -- has also helped Australian exports.

IMPLICATIONS FOR MONETARY POLICY

14. (SBU) The RBA signaled for the first time that it will likely raise interest rates "back towards normal levels" in the near future. Stevens said candidly that although the global economy could suffer a further fall, he expressed confidence that "Chinese policy-makers will grow their economy over the medium term," which

would further shield the Australian economy. Furthermore, Stevens said that "the exceptional monetary stimulus in place at present" will become unnecessary if global economic recovery continues.

Government is More Cautious

15. (SBU) Department of Prime Minister and Cabinet Deputy Secretary for Economics Gordon DeBrouwer said that Government shares Stevens' view that the Australian economy has performed much better than expected over the past eight months. However, the GOA is more cautious in looking at the second half of 2009 because of concerns about that the end of consumer-oriented stimulus spending is likely to slow retail spending and a feeling that unemployment is likely to keep rising. DeBrouwer said that the Government is concerned that Qkeep rising. DeBrouwer said that the Government is concerned that there might still be some bad numbers that could undermine confidence. He said that the RBA position is influenced by its concern that very low interest rates could lead to asset bubbles, particularly in housing.

16. (SBU) COMMENT: Governor Stevens' statement marks a significant turning point for monetary policy in Australia. The RBA considers Australia has emerged in relatively good shape from the global financial crisis. Barring the reappearance of another downturn, the Bank sent a clear signal that it will now move to re-adjust policy settings to ensure a sustainable recovery while keeping inflation in check.

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